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SUBJ: BRAZILIAN ECONOMIC PERFORMANCE - VIEWS OF THE EDITOR OF
"CONJUNTURA ECONOMICA"

1. SUMMARY: THE EDITOR OF BRAZIL'S MOST PRESTIGIOUS JOURNAL
OF CURRENT ECONOMIC AFFAIRS PREDICTS, IN A DRAFT ARTICLE GIVEN
TO US ON AN UNOFFICIAL BASIS, THAT BRAZIL'S GDP WILL GROW BY 7
PERCENT IN 1976; INFLATION BY 45 PERCENT; AND MONEY SUPPLY (M1)
BY 30 PERCENT. HE FORESEES A CURRENT ACCOUNT DEFICIT OF 6.4
BILLION DOLLARS, WHICH REPRESENTS ONLY A MODEST IMPROVEMENT OVER
THE 1975 DEFICIT. THE EDITOR PREDICTS EXCHANGE RATE POLICY
WILL NOT BE CHANGED IN 1977 ALTHOUGH IT NEEDS TO BE. HE FORE-
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SEES CONTINUED, GRADUAL MONETARY RESTRAINT, WITH GDP GROWTH

BELOW 5 PERCENT PER YEAR IN 1977 AND 1978. IF GRADUALISM WERE ABANDONED IN FAVOR OF "SHOCK TREATMENT", HOWEVER, THE EDITOR WOULD FORESEE A MORE SEVERE RECESSION. END SUMMARY.

2. ON NOV 30 IN RIO DE JANEIRO, AN ECONOMIST CONNECTED WITH "CONJUNTURA ECONOMICA" GAVE VISITING EMBOFF A COPY OF A PRELIMINARY DRAFT OF THE "PANORAMA" ARTICLE SCHEDULED TO APPEAR (IN UPDATED FORM) IN THE FEBRUARY 1977 YEAR-END REVIEW ISSUE OF CONJUNTURA. THE DRAFT WAS WRITTEN BY THE CONJUNTURA'S CHIEF EDITOR, PREFESSOR ANTONIO CARLOS LEMGRUBER OF THE GETULIO VARGAS FOUNDATION. OUR SOURCE ASKED THAT THE DRAFT, AND ESTIMATES CONTAINED IN IT, NOT BE DIVULGED. EXCERPTS (PARAPHRASED) FROM THE DRAFT FOLLOW IN PARAS 3-11; PARA 12 CONTAINS A BRIEF EMBASSY COMMENT. BEGIN EXCERPTS FROM DRAFT "CONJUNTURA" ARTICLE.

3. PERFORMANCE IN 1976 - GDP GROWTH IS CALCULATED TO BE ON THE ORDER OF 7 PERCENT, VERSUS 4.0 PERCENT IN 1975. THE INDUSTRIAL SECTOR, PARTICULARLY MANUFACTURING, SHOWS AN ACCENTUATED EXPANSION, BETWEEN 8 AND 9 PERCENT IN 1976, VERSUS 4.2 PERCENT IN 1975. INDUSTRIAL EXPANSION BEGAN TO DECELERATE IN THE FOURTH QUARTER OF THIS YEAR. AGRICULTURAL GROWTH IS EXPECTED TO BE LOW, ABOUT 3 PERCENT, OWING TO THE REDUCED COFFEE CROP.

4. NORMALLY, THIS REAL GROWTH WOULD BE CONSIDERED AN EXCELLENT RESULT -- 7 PERCENT CORRESPONDS TO BRAZIL'S AVERAGE ANNUAL RATE OF GDP GROWTH OVER THE LAST 25 YEARS. THE CONTINUED VERY HIGH RATE OF CAPACITY UTILIZATION, HOWEVER, LEADS SOME ECONOMISTS TO VIEW THE GROWTH AS EXCESSIVE. THE INFLATION AND BOP PROBLEMS PERHAPS REQUIRED LOWER GROWTH.

5. INFLATION, DECEMBER-TO-DECEMBER, IS ESTIMATED AT 45 PERCENT IN 1976, AS AGAINST 29.4 PERCENT IN 1975 AND 35.2 PERCENT IN 1974. THE RATE OF INFLATION DECLINED IN THE FOURTH QUARTER. THE ACCELERATION OF INFLATION IN 1976 WAS CAUSED BY THE MONETARY EXPANSION IN THE SECOND-HALF OF 1975 AND THE FIRST-QUARTER OF 1976.

6. THE BOP IMPROVED THIS YEAR BUT THE GAIN WAS NOT SATISFACTORY. THE EXPECTED CURRENT ACCOUNT DEFICIT OF \$6.4 BILLION REPRESENTS LITTLE SIGNIFICANT IMPROVEMENT. THIS FIGURE IS BASED ON ESTIMATED LIMITED OFFICIAL USE

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EXPORTS OF 9.6 BILLION DOLLARS; IMPORTS OF 12.0 BILLION DOLLARS; AND A SERVICES DEFICIT OF 4.0 BILLION DOLLARS. THE SURPLUS OF THE CAPITAL ACCOUNT IS ESTIMATED TO BE 7.4 BILLION DOLLARS, LEAVING A 1.0 BILLION BOP SURPLUS AND A FOREIGN DEBT AT YEAR END "IN GROSS TERMS" OF 30 BILLION DOLLARS.

7. IF EXCHANGE RATE POLICY HAD BEEN USED WITH GREATER FORCE IN 1974 AND 1975, EXPORT GROWTH IN 1976 (10 PERCENT) COULD HAVE

BEEN LARGER. EVEN THOUGH THE GROWTH OF INDUSTRIALIZED COUNTRIES IN 1976 WAS 5 PERCENT, VERSUS MINUS 2 PERCENT IN 1975, THE RATE OF GROWTH OF BRAZIL'S EXPORTS THIS YEAR WAS ABOUT THE SAME AS IN 1975; THE SAME HOLDS FOR EXPORTS OF INDUSTRIAL PRODUCTS, 8 PERCENT GROWTH IN 1975 VERSUS 7 PERCENT IN 1976. THERE WAS A SEVERE DECLINE IN THE PHYSICAL QUANTITIES OF EXPORTS IN 1976 RELATIVE TO 1975. APPARENTLY, THE POSITIVE (WORLD) INCOME EFFECT ON BRAZILIAN EXPORTS WAS NULLIFIED BY THE UNFAVORABLE PRICE EFFECT CAUSED BY THE DESTIMULATING CHARACTER OF LOW EXCHANGE RATE DEVALUATIONS, AND ALSO POSSIBLY BY THE INTERNAL SITUATION OF FULL CAPACITY AND SUPER-HEATED DEMAND.

8. IMPORTS REMAINED AT ABOUT THE SAME LEVEL IN 1976 AS IN 1975. THREE REASONS SEEM TO HAVE IMPEDED A DECLINE, DESPITE THE SEVERE IMPORT CONTROLS: (A) EXCESSIVE GDP GROWTH; (B) LOW EXCHANGE RATE DEVALUATIONS; AND (C) THE 18 PERCENT INCREASE IN PETROLEUM IMPORTS IN 1976, WHICH IMPLIES A FALL OF ABOUT 8 PERCENT IN OTHER IMPORTS. THE PETROLEUM IMPORT INCREASE (BASICALLY A QUANTITY INCREASE) COULD REFLECT A STOCK BUILD-UP IN ANTICIPATION OF A NEW PRICE RISE.

9. OUTLOOK FOR THE FUTURE.

A) EXCHANGE RATE - IN 1976, EXCHANGE RATE POLICY CONTINUED TO REFLECT THE DIFFERENCE BETWEEN INTERNAL AND WORLD INFLATION (45 AND 8 PERCENT, RESPECTIVELY). BUT, AS OCCURRED IN 1975, EFFECTIVE DEVALUATION -- RELATIVE TO THE CURRENCIES OF ALL TRADING PARTNERS, NOT JUST THE DOLLAR -- WAS WELL BELOW 35 PERCENT, THE PREDICTED ACCUMULATED CRUZEIRO-TO-DOLLAR DEVALUATION FOR THIS YEAR. FOR THE NEXT FEW YEARS, EVERYTHING LEADS ONE TO SUPPOSE THAT THIS POLICY -- ALTHOUGH INCORRECT -- WILL BE MAINTAINED.

B) MONETARY POLICY. ESTIMATED MONETARY EXPANSION (M1) IN 1976 IS ESTIMATED TO BE 30 PERCENT (VERSUS 42.8 PERCENT IN LIMITED OFFICIAL USE

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1975), AND THE EXPANSION OF BANK CREDIT WILL BE 50 PERCENT (VERSUS 56.7 PERCENT IN 1975). DECELERATION OF THOSE HIGH RATES OF EXPANSION CLEARLY IS OCCURRING. IN THE NEXT FEW YEARS, WE PRESUME THAT THE POLICY OF GRADUAL MONETARY DECELERATION WILL BE MAINTAINED, FOR EXAMPLE WITH EXPANSION RATES OF 25 PERCENT IN 1977 AND 20 PERCENT IN 1978.

C) FISCAL POLICY. WE ASSUME THE CONTINUANCE OF RELATIVELY BALANCED BUDGETS.

10. WITHIN THIS FRAMEWORK OF POLICIES, WHAT IS THE ECONOMIC OUTLOOK FOR THE NEXT FEW YEARS? ASSUMING THE GRADUALIST MONETARY SQUEEZE CONTINUES THROUGH 1977 AND 1978, THESE COULD BE GOOD YEARS FOR INFLATION AND THE EXTERNAL SECTOR, ALTHOUGH IMPROVEMENT IN THESE TWO AREAS COULD BE RELATIVELY SLOW. NATURALLY IT IS HOPED THAT GROWTH WILL BE LOW, STILL POSITIVE BUT

BELOW 5 PERCENT PER YEAR. A SUBSTANTIAL DROP IN INFLATION SHOULD OCCUR IN THE FIRST PART OF 1977, WITH SLOWER DECLINES LATER. CERTAINLY INFLATION WOULD RETURN TO ITS "NORMAL" RATE OF 20 PERCENT BY 1978. A TRADE SURPLUS WOULD EMERGE ONLY IN 1978, AND THERE WOULD STILL BE HIGH CURRENT ACCOUNT DEFICITS IN 1977 AND 1978. IN THE YEAR 1979, IT IS POSSIBLE THAT THE ECONOMIC SITUATION WOULD AGAIN BE FAVORABLE -- ONE COULD IMAGINE THE START OF A NEW FAVORABLE CYCLE, SIMILAR TO THAT OF 1968-73.

11. THE MOST INTERESTING ALTERNATIVES THAT MIGHT BE CONSIDERED RELATED TO THE ABANDONMENT OF GRADUALISM:

-- A MAXI-DEVALUATION;

-- MORE SEVERE MONETARY DECELERATION IN 1977, AT THE HIGH COST OF A MORE SEVERE RECESSION IN 1977-78, WITH ZERO OR EVEN NEGATIVE GROWTH. PERHAPS THE BENEFITS AREN'T WORTH THE COSTS, AT LEAST AT FIRST GLANCE. IF, HOWEVER, THE "STOP AND GO" MONETARY POLICIES OF 1975 ARE REPEATED IN 1977, THE ESTIMATES IN THIS ARTICLE WOULD LOSE SOME OF THEIR VALIDITY. IN THIS CASE, ONE COULD EXPECT A NEW INFLATIONARY ACCELERATION IN 1978 AS WELL AS PROBLEMS WITH THE EXTERNAL SECTOR. THE GOVERNMENT HAS TO CONFRONT THE SHORT-RUN DILEMMA BETWEEN RECESSION AND INFLATION, ANALYSING THE BENEFITS OF SHOCK TREATMENT AND GRADUALISM. END EXCERPTS FROM DRAFT "CONJUNTURA" ARTICLE.

12. COMMENT. THE ESTIMATES OF ECONOMIC AGGREGATES IN THE DRAFT ARTICLE SEEM GENERALLY REASONABLE, AL-
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THOUGH THE EMBASSY'S ESTIMATES FOR SOME AGGREGATES DIFFER (E.G., WE FORESEE AGRICULTURAL GROWTH OF ABOUT 5 PER CENT, AND INFLATION PROBABLY SOMEWHAT HIGHER THAN 45 PER CENT). THE YEAREND 1976 DEBT ESTIMATE OF 30 BILLION DOLLARS SEEMS TOO HIGH BY DOLS 1-2 BILLION, EVEN ALLOWING FOR FURTHER RAPID ACCUMULATION OF SHORRT-TERM DEBT BETWEEN NOW AND YEAR-END. THE ARTICLE'S BLUNT LANGUAGE ON EXCHANGE RATE POLICY, IF PRINTED, WILL TAKE "CONJUNTURA" INTO A STRONGER POSITION ON THIS QUESTION THAN IT HAS TAKEN TO DATE. WE BELIEVE IT IS RATHER EARLY TO MAKE PREDICTIONS ON THE END OF THE OFT-REFERRED-TO TRANSITION PERIOD, NOTWITHSTANDING THE ARTICLE'S OPTIMISM ABOUT 1979 AND BEYOND.
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